

“Pension – Tension”

The Police Officer Pension Debate

Another day, another scheduling problem! Sergeant Jones was tired and his day had only just begun. Where was he going to find enough officers to work night shift? It seemed like every patrol shift at the Smithtown Police Department was working at below minimum staffing. The problem didn't stop there; the Detective Bureau didn't have enough officers and forget about having anyone assigned to Traffic! “It wasn't always this way” thought Jones.

“Just a few years ago, we were fully staffed and had a waiting list of applicants” he said to no one in particular. “We were just glad to have a job; heck, I would have done it for free.” Staffing wasn't the only problem the Department faced, and it probably wasn't its worst. Sergeant Jones knew that morale in the department was at an all time low. Shift briefings were less now about crime and arrests, and more about staffing complaints, gripes about benefits and time off and discussions about the group's 401(k) plans. It certainly hadn't always been this way; Jones had a pretty good idea what had changed.

Politicians in Jones' state had signed legislation prohibiting defined benefit pension plans for all new public employees a little more than two years ago. Their idea was for all new employees to enroll in a “defined contribution” retirement plan while allowing current employees to remain in the current “defined benefit” plan. The idea was sold to the public as a way for state and local governments to control costs and eliminate overly

generous pensions. Sergeant Jones laughed to himself, knowing legislators weren't the ones having to deal with the fall-out of the plan. Recruitment for new officers had become a nightmare. Why would anybody want to take the risks involved in law enforcement for a future retirement dependent on the whims of the stock market while your peers can rest easy with a guarantee their retirement money will be there when they need it? How many of those wishing to enter policing were also competent financial planners? Who would help them avoid the pitfalls of numerous private pension plans that had gone bankrupt? How would managers reconcile the tension created when older officers realize the lack of current contributions means their plans might also close shop? To Sergeant Jones, it sounded like a lot of wishful thinking.

The Debate

In his 2005 State of the State address, California Governor Schwarzenegger described the State's public employee pension obligation as "Another financial train on another track to disaster." This salvo against public pensions drew a "line in the sand" for what may become the most emotionally charged public debate in recent history.¹ Caught directly in the crosshairs of Governor Schwarzenegger's desire to reform public employee retirement benefits are the men and women employed by law enforcement agencies across the State.

¹ Schwarzenegger, Arnold. "State of the State Address." California State Capital, California. 05 Jan. 2005.

For many peace officers and their families, the security provided by the current defined benefit retirement system² only partially compensates for the stress, physical dangers and other negative aspects of the job. Any change to the current retirement system would likely lead to major changes in law enforcement agencies of all sizes. Although fiercely contested by cops, firefighters and others in California's public pension plans, these changes are positive or negative depending upon which side of the debate with which you agree.

The Deficit

During the past several years, California has suffered through the largest state budget deficit in its history.³ The budget deficit has been responsible for the elimination of many services and increases in a variety of taxes and fees. It was also responsible, in part, for the historic recall of Governor Gray Davis and the election of actor turned politician Arnold Schwarzenegger. The State is not alone in its struggles with mountainous deficits. The majority of counties and cities in the State are also facing fiscal crises of their own.⁴ Exacerbating the problem for municipalities are laws that place onerous restrictions on a local entity's ability to impose any level of added taxes while the need and cost to provide basic services continue to increase.

² A Defined Benefit plan promises a specific monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount or more commonly, it may calculate a benefit through a plan formula that considers such factors as salary and service. U.S. Department of Labor. "Retirement Plans, Benefits & Savings." 31 October 2005. <<http://www.dol.gov>.

³ Budget year 2003-2004 approximately \$38.2 billion. "The 2003-04 Budget Gap. June, 2003. <<http://www.cbp.org>. Budget year 2004-2005 approximately \$17 billion. "Governor Proposes Deep Cuts, Borrowing in 2004-05 Budget. March, 2004. <<http://www.cbp.org>.

⁴ Institute For Local Self Government. "The Fiscal Condition of California Cities." 2003. <<http://www.ilsg.org>.

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As the budget crisis has continued to grow, a debate regarding public employee pension plans and their effect on state and local budgets has intensified. The issue became front-page news in January 2005 when the Governor announced his reform agenda during his State of the State Speech. According to Schwarzenegger, the State's pension obligation in 2000 was \$160 million, but had ballooned to \$2.6 billion by the end of 2004. He proposed scrapping the State's current "defined benefits" retirement plan in favor of one for all new employees that would base benefits on the employee's contributions to a private plan over the span of their careers. In his announcement of the proposal, the Governor said taxpayers cannot afford to continue paying for the archaic and enormously expensive state pension plans.⁵

For many years, the defined benefit model was the main type of retirement plan offered by large employers, with specific pension guarantees based on a formula that increases the benefit amount proportionally with the employee's years of service. Under the State's defined benefit plan through the California Public Employees Retirement System (CalPERS), the retiree is entitled to the promised specific benefit. Employers and employees are required to set aside money to pay the promised benefits, and many also have agreed under local contracts with employee groups to pay the worker's share of the contribution to CalPERS. As noted by Governor Schwarzenegger, the defined benefit plan is being replaced by many employers with a defined contribution plan.⁶ Under a defined contribution plan, the employee (often aided by employer matching contributions) sets aside a specific amount of money at regular intervals. These are

⁵ Schwarzenegger, Arnold. "State of the State Address." California State Capital, California. 05 Jan. 2005.

⁶ Schwarzenegger, Arnold. "The Governor's Reform Agenda." 05 Jan. 2005. <<http://www.governor.ca.gov>.

usually known as 401(K) plans. At retirement, the employee has an account balance which is completely dependent upon how much has been put into the fund and how those contributions have grown over the time they have been invested. In a defined contribution plan, the employee is at risk if invested funds don't perform at a consistently high level. The Governor's proposal does not spell out who is responsible for administering a defined contribution plan or the cost.

Schwarzenegger's call to move new state employees to a defined contribution plan was supported by a proposed constitutional amendment introduced by Assemblyman Keith Richman in December of 2004. Assembly Constitutional Amendment 5 would establish the California Public Employee Defined Contribution Plan. The measure provides that on July 1, 2007, any person hired as a new employee by a public agency in the State may enroll only in a defined contribution plan of a public pension or retirement system and is prohibited from enrolling in a defined benefit plan. The measure would limit employer contributions in a defined contribution plan to an unspecified percentage of an employer's payroll and establish other parameters for the defined contribution plans.⁷

As one can imagine, the comments by the Governor and the constitutional amendment proposed by Assemblyman Richman met with swift and strong resistance by organizations such as the Peace Officer's Research Association of California and the California Chiefs of Police Association. CalPERS published a research brief in December of 2004 entitled "A review of the myth and realities of Defined Benefit and Deferred Compensation Plans." The research brief concluded that the claim of excessive

⁷ Richman, Keith. "ACA5." Legislative Counsel's Digest 06 Dec. 2004. <<http://www.info.sen.ca.gov>.

benefits in the defined benefit plan is a myth. According to their research, the average age at retirement for workers in state pensions is 60 with 19.5 years of service. The average benefit allowance is \$1,673.82 a month. In the public safety realm, the average California Highway Patrol employee retires at age 55 with 27.9 years of service and receives an allowance of \$3,811.27.⁸

CalPERS research also concluded that defined contribution plans don't cost less, and may cost more than a defined benefit plan. They base this conclusion on a premise of the higher administrative cost of defined contribution plans, and their traditional higher operating expenses, start-up costs and the diminished ability of the State to use investment returns to cover retirement costs. The research brief also pointed out that defined contribution plans threaten employee retirement security. The security risks include employees outliving their retirement assets, the fact defined contribution plans do not include inflation protection, that employees would be without either disability or death benefits and a likelihood the defined contribution plan would not provide adequate benefits.⁹

CalPERS points to the State of Nebraska as an example of the failure of individuals in a defined contribution plan to provide themselves with adequate retirement income.¹⁰ A study approved by the Nebraska Public Employees Retirement Board (PERB) and

⁸ California Public Employees' Retirement System (CalPERS). "A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans." Dec. 2004. Pg 1.

⁹ California Public Employees' Retirement System. "A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans." Dec. 2004. Pg 3-4.

¹⁰ California Public Employees' Retirement System. "A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans." Dec. 2004. Pg 4.

conducted by Buck Consultants in 2000 found that over 20 years, public employees in a mandatory defined contribution plan posted an average return of six to seven percent, compared to 11 percent for the state's three defined benefit plans.¹¹ Based on the Buck study, CalPERS concluded that Nebraska public employees in their defined contribution plan made poor investment choices and posted weaker returns than those employees still enrolled in the State's defined benefit plan. Anna Sullivan, Executive Director of the Nebraska Retirement System, came to the conclusion that professional money managers (i.e. the State's Investment Council) had a better investment return than what the individual participant could realize by his/her own allocation of assets.¹²

Historical Perspective

The CalPERS defined benefit pension plan has been an important part of the total pay and benefit package for sworn police officers in California since 1939.¹³ With peace officers filling the role of everything from social worker to marriage counselor and with the ever-increasing physical danger of the job, the defined benefit retirement plan offers the knowledge that a secure retirement is waiting for those who remain in the profession until retirement age.

In 1991, then-Governor Pete Wilson proposed major public employee pension reform to close the State's budget deficit. The proposal, adopted into the State budget that year, included eliminating a supplemental benefit reserve, providing enhanced inflation

¹¹ Benefit Review Study of the Nebraska Retirement Systems. August 2000. Buck Consultants.

¹² Nebraska Sees Red Over Its 401(k) Plans. K.C. Swanson. The Street.com. May 7, 2002.

<<http://www.thestreet.com>.

¹³ California Public Employees' Retirement System. "Facts at a Glance." <<http://www.calpers.ca.gov>.

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protection, closing a miscellaneous (Tier I) plan and restructuring the Public Employees' Retirement System Board. Governor Schwarzenegger's current proposal is different from the proposal in 1991 in that it seeks to close all defined benefit plans to new hires and provide defined contribution plans. According to the Governor, his plan would reduce California's pension obligation, bring public employee retirement plans more in line with those in the private sector and reduce the financial burden on taxpayers.¹⁴

Historically, the small police agency has used the CalPERS defined benefit pension plan to help recruit and retain qualified police officers. Small police agencies¹⁵ account for the majority of police departments nationwide with about 77 percent having fewer than 25 police officers. About half have fewer than 10 officers.¹⁶ Most small police agencies have a difficult time competing with their larger counterparts to recruit qualified officers when salary, promotional opportunities and a variety of work assignments are determining factors for the prospective employee. Most small agencies have been able to offer potential officers a defined benefit pension plan by participating in systems such as CalPERS. Although larger police agencies also participate in CalPERS or other defined benefit plans, any negative influence to recruitment and retention caused by a change in pension plans would have a greater effect on the small police agency due to their limited hiring and career development opportunities.

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¹⁴ Schwarzenegger, Arnold. "The Governor's Reform Agenda." 05 Jan. 2005.
<<http://www.governor.ca.gov>.

¹⁵ For purposes of this article, a "small police agency" is described as having 50 or fewer sworn officers.

¹⁶ Hickman, Matthew J. & Reaves, Brian A. Bureau of Justice Statistics, U.S. Dept. of Justice, Local Police Departments 1999. Oct. 2001.

The California Employment Development Department estimates California will hire 35,000 peace officers in county and municipal agencies during the coming decade. This will result in a “seller’s market” where employees will demand higher salaries and benefit packages for their services.¹⁷ CalPERS believes changing to a defined contribution plan will hamper recruitment and retention and lead to a less capable work force.¹⁸

The capabilities of the future workforce have been the subject of intense debate amongst individuals in the profession and those outside of it. Many non-law enforcement people believe that changing the retirement system will have little or no effect on the hiring and retaining of qualified officers. They believe most individuals are drawn to the law enforcement profession for reasons other than pay and benefits. Jody Hall-Esser, a retired City Manager from Culver City, California, supported this belief by stating it was her opinion that a change in the current retirement system would have little effect on the recruitment of new police officers. She believes most individuals are attracted to the profession for the “excitement” and other aspects of the job, rather than the pay and benefits.¹⁹

Possible Impacts on the Local Law Enforcement

In order to adequately assess the impact on local police agencies of the change from defined benefit to defined contribution pension plans, a group of individuals from diverse

¹⁷ Harpole, Rich. “The Importance of Recruitment Marketing Strategies For Small Remote Agencies.” The Journal of California Law Enforcement Jan. 2005.

¹⁸ California Public Employees’ Retirement System. “A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans.” Dec. 2004.

¹⁹ Nominal Group Technique Exercise. Signal Hill, California. April, 2005.

backgrounds (both law enforcement and other professions) was assembled to discuss possible pension reform. A secondary goal of this group was to develop thoughtful solutions to help police managers prepare for the associated future challenges and opportunities should the State convert its pension plans to the defined contribution model. Panel members agreed that most employers are willing, and in some cases anxious, to shift the pension investment decision-making and associated risks to the employee. Many felt the employer would be willing to shift the responsibility to reduce financial responsibility and liability. The group also felt strongly that most taxpayers were becoming less willing to shoulder any increases in public employee pension costs.

The positive aspects of pension reform identified by the panel included possible budget savings for individual law enforcement agencies through reduced annual employer contributions and greater predictability of future pension costs. Savings realized through the reduced costs could be applied to hiring more officers or the updating of equipment. The non-law enforcement individuals on the panel also felt public perception of law enforcement, in regards to pay and benefits, would increase if retirement benefits for public employees were more in line with the benefits received by the general public. They felt many taxpayers were unhappy having to pay for retirement benefits that continue to rise in cost and are superior to their own. This perceived inequity could cause some citizens to withhold support for police agencies.

The group spent a considerable amount of time discussing the possible effects of pension reform on law enforcement's ability to recruit and retain qualified police officers. Police

personnel on the panel were extremely vocal in their opinion that changing to a defined contribution plan would have a negative impact on recruiting new officers. A retired Chief of Police asked the question, "If the benefits were equal with other jobs, why become a police officer?" Law enforcement personnel were also worried about the effect on the organization of establishing a "two-tiered" retirement system in which recommended changes to the retirement system would apply to newly hired officers only. This potential inequality could, in fact, lead not only to lower morale, but to difficulties negotiating future pay and benefit packages. CalPERS addressed this very topic in a 2004 report stating "Employees would want a larger employer contribution or a higher salary due to the risks they must assume with a defined benefit versus a defined contribution plan and to compensate for the uneven playing field created when they must work along side of workers who have a higher benefit."²⁰

The panel also discussed the ability of most police officers to make sound financial investment decisions. They generally agreed the majority of police officers would be adversely impacted by their lack of experience or knowledge to handle investment decisions. This issue would be greatly magnified during a financial crisis such as a substantial downturn in the stock market. Investment decisions made by an officer during a financial crisis could very well determine the quality of his or her future retirement. The panel concluded that any changes to the pension investment decision-making process would require means to provide financial planning and counseling for officers. The State of Nebraska attempted to minimize this concern by allowing

²⁰ California Public Employees' Retirement System. "A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans." Dec. 2004. Pg. 8.

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employees time off to attend investment seminars. As previously noted, the results were still weaker investment returns for those employees enrolled in the defined contribution plan versus a defined benefit plan.

Managing the Future

The pension reform debate has opened the door to a wide range of opinions and suggested ideas for change. This, coupled with the ongoing political maneuvering by the Governor and other politicians, makes it extremely difficult for law enforcement agencies to plan for and influence challenges that may occur in the future. Regardless of the uncertainty, law enforcement managers must utilize a strategic planning process to help guide their organizations through what may prove to be difficult change.

Police agencies in California strive to provide quality law enforcement service to those who live and work in the communities they serve. To provide a high level of service, agencies believe in hiring and retaining the highest quality employee possible. To do so, most agencies have chosen to provide its employees with the CalPERS defined benefit pension plan. The move to reform public employee pensions by creating a two-tiered retirement system could negatively impact the hiring and retention of quality employees and create other challenges for the organization. The development of a strategic plan is necessary to maintain the current hiring and retention climate in police agencies. This vision of maintaining the current climate can be achieved by meeting several goals involving both current and future employees of a police agency.

A broad overview of goals include providing information and education related to any pension change for both current and future employees. Current employees must be made to feel comfortable and secure with their pension plan. Any change to the current system must be explained in full to the current employees, with educational opportunities provided to assist with investment decision-making. Future employees must be fully informed of the provisions of their pension plans including any limitations. As with the current employees, educational opportunities need to be provided for pension investment decision-making.

If, in fact, pension reform results in budget savings for individual agencies, all employees need to understand and see the benefits associated with the savings. The benefits include, but are not limited to: increased staffing, acquisition of new equipment and technology, and new services provided to the community.

The greatest impact on police agencies is likely to occur in the area of employee recruitment and retention. Other areas of impact could be the lowering of employee morale and the concerns over the survivability of the CalPERS system. Although it is difficult to determine the potential budget impact of moving from the defined benefit plan to a defined contribution plan on individual police agencies, CalPERS has calculated some costs associated with a defined contribution plan. They conclude the average cost to administer a defined contribution plan is two percent of assets, while the cost of administering their defined benefit plan is 0.18 percent. Converting new employees to a defined contribution plan will also raise the cost of the existing defined benefit plan over

time. Employer and employee contributions for employees enrolled in a defined contribution plan would go directly into an employee account and could not be used to cover unfunded liabilities in the defined benefit plan. Diverting new participants into a defined contribution plan, the employer will be required to continue to maintain the defined benefit plan, mitigating or nullifying any expected budget savings.²¹

Any and all strategies employed as part of a strategic plan must relate to the overall vision of maintaining a climate in police agencies that allows for the continued hiring and retention of quality employees. Hiring and retaining quality employees is essential for police agencies to provide the highest level of police services that each community deserves. As negotiations between the Governor's office and labor groups continue, it is too soon to know exactly what form pension reform will take. Regardless of the exact form, police agencies need to engage in strategic planning to take advantage of future opportunities and manage challenges associated with the change.

Conclusion

It is clear all police agencies must plan now for the potential impact of pension reform on their individual agencies. Each agency must assess their strengths and weaknesses and identify those individuals or groups both within the organization and outside that will be most affected by the change. Using this information, police agencies can develop plans to implement change and manage the impact, hopefully in a positive manner for the organization.

²¹ California Public Employees' Retirement System. "A Review of the Myth and Realities of Defined Benefit and Deferred Compensation Plans." Dec. 2004. Pg. 2.

During research for this article, the author found the majority of individuals felt some type of public employee pension reform would take place. It is difficult to say at present if the reform will be a new defined contribution plan or something yet to be identified. In November 2005, Governor Schwarzenegger called for a special statewide election to pass four key propositions he strongly supported. Although none of the propositions directly addressed the pension reform debate, one did attempt to require union officials to obtain employee permission before using revenue from union dues for political purposes. Many in the law enforcement community viewed this proposition as an attempt to silence their collective voices on issues such as pension reform. All of the propositions supported by the Governor were soundly defeated. It is unclear how this recent political defeat will influence Schwarzenegger's attempt to change public employee's pension plans, but he has already publicly stated he will work for greater cooperation solving key issues facing the State.²²

The key to successful reform will be cooperation between all parties with the common goal of fair and equal reform. It appears that this is the only viable alternative if government employers want to remain competitive with job opportunities in the private sector and attract and retain the best and brightest at all levels.

²² John M. Broder. "Not On Ballot, Schwarzenegger Is Still Rebuked." The New York Times. 10 Nov. 2005.